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Supreme Court of the United States.

OCTOBER TERM, 1942.

BOSTON ELEVATED RAILWAY COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

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The petitioner, Boston Elevated Railway Company, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the First Circuit entered in the above-entitled cause on November 4, 1942.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 98-118) is reported at 45 B.T.A. 906. The opinion of the Circuit Court of Appeals (R. 127-135) is not yet reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on November 4, 1942 (R. 135). The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code, as amended by Act of February 13, 1925.

Question Presented.

Whether certain payments or advances made to petitioner by the Commonwealth of Massachusetts under legislative Act (Mass. Sp. Stat. 1918, c. 159, as amended), which were required under certain conditions specified in said Act to be repaid by petitioner to the Commonwealth, should be included in petitioner's gross income in the year received for the purpose of taxation.

Statutes Involved.

The material portions of Mass. Sp. Stat. 1918, c. 159, and amendatory Acts, are printed in the Appendix, *infra*, pp. 10-28.

Statement.

The Boston Elevated Railway Company is a corporation engaged in the business of transportation of passengers by means of elevated, subway, surface railway and bus lines in the City of Boston and suburban cities and towns. Since July, 1918, the company, and all of the properties owned, leased and operated by it, have been managed and operated under chapter 159 of the Special Acts of the General Court of Massachusetts for the year 1918 (hereinafter referred to as the Public Control Act), as amended, by a Board of Trustees appointed by the Governor of the Commonwealth (R. 63, 101).

The Public Control Act provided, *inter alia*, that the trustees should from time to time fix rates of fare sufficient to cover the cost of service, as defined in said Act (sec. 6). A reserve fund was established under the requirements of said Act which provided that, whenever the income of the company was insufficient to meet the cost of the service, the

reserve fund should be used to make up such deficiency, and that whenever, on the other hand, such income was more than sufficient to meet the cost of the service, the excess should be transferred to and become a part of the reserve fund (sec. 9).

The Act also provides that if, as of the last day of June in any year (as to years subsequent to 1934 this date has been changed by statute from June to March), the amount remaining in the reserve fund was insufficient to meet the deficiency in income, the trustees should notify the Treasurer of the Commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and that the Commonwealth should thereupon pay over to the company the amount so ascertained (sec. 11). The Act further provided that the Commonwealth should thereupon make a proportionate assessment of the amount of any such deficit payment by an addition to the next state tax upon the cities and towns served by the company (sec. 14).

Said Act further provided that if, as of the last day of June in any year (March, as to years subsequent to 1934), the reserve fund should exceed the amount originally established, the trustees should apply the excess, so far as necessary, to reimburse the Commonwealth for any amounts which it had theretofore paid to the company, and that the Commonwealth should thereupon distribute the amount so received among the cities and towns in which the company operated in proportion to the amounts for which they had been respectively assessed (sec. 11).

At the expiration of the period of public control, if the reserve fund should be less than the amount originally established, the Commonwealth is required to pay over to the company an amount sufficient to restore it to its original amount, and, on the other hand, if the reserve fund then should exceed the amount originally established, such excess

is required to be paid by the company to the Commonwealth (sec. 13). The period of public control was extended by Mass. St. 1931, c. 333 (Appendix, p. 21), to July 1, 1959, and thereafter unless terminated in the manner therein provided.

As of the last day of June in the years 1933 and 1934 and as of the last day of March in the years 1935 to 1937, inclusive, there was a deficiency, as referred to in said Act, in the income of the company and, there being no amount remaining in the reserve fund on any of said dates, the Commonwealth, upon notification by the Trustees, paid over to the company in each of said years the amount of the respective deficiencies, in accordance with the terms of said Public Control Act (R. 107-109). The controversy relates to the taxability of these payments.

The Board of Tax Appeals held that the payments made to petitioner by the Commonwealth in each of said years should be taken into petitioner's gross income for the purpose of taxation, and entered its decisions determining deficiencies accordingly (R. 118-119). Petitioner filed a petition for review with the Circuit Court of Appeals for the First Circuit and that court affirmed the decisions of the Board of Tax Appeals (R. 135).

Reasons for Granting the Writ.

1. The decision of the court below decides an important question of federal law which has not been, but which your petitioner submits should be, settled by this court. The question of whether payments or advances made to petitioner by the Commonwealth under the terms of the Public Control Act should be included in petitioner's gross income for the purpose of taxation in the year received is of great import to the Commonwealth of Massachusetts and to the cities and towns upon which rest the ultimate burden of

meeting annually any deficiencies, including taxes, resulting from petitioner's operations. By the term of St. 1931, c. 333, sec. 1 (Appendix, p. 21), public management and operation of petitioner is to continue at least until 1959. In each unprofitable year during this period when a deficit is experienced, the same question will recur, and in each profitable year when the operating income of petitioner exceeds the cost of the service and a repayment back to the Commonwealth is made by petitioner under the requirement of section 11 of the Public Control Act, the correlative question of the deductibility for tax purposes of such repayments will be involved. The question of whether in a prosperous year the earnings of petitioner in excess of the cost of the service are subject to federal income taxation, or of whether repayments in subsequent years made by petitioner to the Commonwealth are deductible for tax purposes in the year when such repayments are made, should depend upon the primary question of whether the payments or advances made by the Commonwealth under section 11 of the Public Control Act are taxable to petitioner in the year received.

The correctness of the decision of this primary question by the Circuit Court of Appeals, affecting, as it does, in each year during the remaining period of public control, the rights and liabilities not only of petitioner, but of all of the taxpayers in the cities and towns served by the railway system, presents an important question of federal law that should be settled by this court.

2. An additional reason for the granting of the writ is that the decision of the court below is in conflict with the decisions of other Circuit Courts of Appeals.

In the cases of *McKnight, Adm.*, v. *Commissioner*, 127 Fed. (2d) 572, and *Clinton Hotel Realty Corporation* v.

Commissioner, 128 Fed. (2d) 968, the Circuit Court of Appeals for the Fifth Circuit held that advances subject to repayment did not constitute taxable income, because of the offsetting obligation to repay.

In *Island Creek Petroleum Co.* v. *Commissioner,* 57 Fed. (2d) 992 (certiorari denied, 287 U.S. 646), the Circuit Court of Appeals for the Fourth Circuit held that the fact that the obligation to repay was contingent did not affect the taxable character of the transaction, saying:

> "And it makes no difference in the result if we construe the agreement as requiring repayment by the Texas corporations only in the event that their operations should prove successful. A loan is no less a loan because its repayment is made contingent . . ."

Section 11 of the Public Control Act provides in part as follows:

> "Section 11 [as amended by Sp. Acts of 1919, c. 244]. If as of the last day of June* in the year nineteen hundred and nineteen, or the last day of any June* thereafter, the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained.
>
> . . . . . .
>
> "If as of the last day of any June* thereafter during the period of public operation the reserve fund

*As to years subsequent to 1934, this date has been changed from "June" to "March." St. 1935, c. 99.

> shall exceed the amount originally established, the trustees shall apply the excess so far as necessary to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof."

The same question presented by the instant cases was before the Board of Tax Appeals in cases involving earlier years, and the Board there decided, contrary to its decision in the instant cases, that the payments from the Commonwealth to petitioner were not income taxable to petitioner. *Boston Elevated Railway Co.* v. *Commissioner*, 37 B.T.A. 494. In its former decision the Board said:

> "It is thus apparent that by the very language of the acts which form the agreement between the petitioner and the commonwealth both parties thereto understood and agreed that the payments back and forth through the reserve fund were advances and repayments as the profitable or unprofitable operations of the railway dictated. The sum of $1,775,338.80, therefore, was not income taxable to the petitioner in 1932."

It is submitted that this is a correct statement of the situation.

The court below, in concluding that the payments by the Commonwealth were not in the nature of loans or advances subject to repayment under the conditions specified in section 11 of the Public Control Act, lays considerable stress upon the provisions of section 13 of that Act, which require, upon the expiration of the period of public control, that the Commonwealth shall make up any deficiency in the reserve fund and that any sum then in the reserve fund in excess of the amount originally established

shall be paid over to the Commonwealth. But this in no way relieves petitioner of the obligation imposed by section 11 to repay annually out of excess earnings all amounts theretofore advanced by the Commonwealth. The requirement that the company shall pay over to the Commonwealth at the end of the period of public control the excess sum, if any, then in the reserve fund over the amount originally established is, as the court below correctly observes, applicable even if petitioner had repaid to the Commonwealth all amounts previously advanced, or, indeed, even if the Commonwealth had made no previous advances. This, however, does not derogate from the definite obligation imposed by section 11 of the Act upon petitioner to repay annually out of excess earnings all amounts theretofore advanced by the Commonwealth. It merely imposes an additional obligation upon petitioner at the end of the period of public control.

The court below considered that the instant cases were controlled in principle by the decision of this court in *Texas & Pacific Railway Co.* v. *United States,* 286 U.S. 285. In this respect petitioner submits the court was in error. That case dealt with a payment received by the company there involved under the Transportation Act of 1920, guaranteeing a minimum operating income for a period of six months after the relinquishment of federal control, upon condition of the carrier's agreement that, if its operating revenue for that period should exceed the specified amount, the excess should be paid into the Treasury. This agreement covered but a single six months' period. If a carrier's income for such period fell below the specified minimum, as it did with the railroad involved in the above case, the difference was paid by the government, without any obligation—contingent or otherwise—upon the carrier to repay anything. The payments made to the carrier in that case represented a final settlement determined after the

expiration of the guaranteed period, and was received by it free and clear. What it received it had the unconditional right to keep.

That case would be analogous to a payment made by the Commonwealth in final settlement at the end of the period of public control, when there would be no obligation upon the company subsequently to repay anything. But the payments involved in the instant cases were *interim* payments which petitioner was obligated to repay in subsequent years under the conditions specified in section 11 of the Public Control Act. The only question here presented is as to the effect of this offsetting obligation. It is obvious that the *Texas & Pacific Railway* case, *supra,* where this question was in no way involved is not in point.

Conclusion.

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

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